



## Annual Financial Statements for 2005/06 for municipalities and municipal entities

This circular is intended to provide guidance to municipalities on the preparation and timely submission of the annual financial statements for municipalities and entities for the 2005/06 financial year. The circular must be read in conjunction with Circular 18 on accounting standards dated 23 June 2005.

The following issues relating to the annual financial statements are clarified in this circular:

- Applicable accounting standards and formats;
- Specimen municipal annual financial statements;
- Consolidated specimen financial statements;
- Timing and implementation by capacity;
- Withdrawal and resubmission of financial statements;
- The municipal audit file;
- Additional disclosures: and
- Non compliance with Chapter 12 of the MFMA

### Applicable accounting standards and formats

The GRAP and GAMAP standards approved by the Accounting Standards Board (ASB) as at 31 December 2004 are contained in the table below. These exclude new standards approved after 31 December 2004. The standards evolve over time and old standards are repealed/updated as new ones are developed.

#### 3 Standards of Generally Recognised Accounting Practice (GRAP)

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| Preface to Standards of Generally Recognised Accounting Practice       |
| GRAP 1 Presentation of financial statements                            |
| GRAP 2 Cash Flow statements  |
| GRAP 3 Accounting policies, changes in accounting estimates and errors |

#### 8 Standards of Generally Accepted Municipal Accounting Practice Standards (GAMAP)

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| GAMAP 4 Effects of changes in foreign exchange rates                             |
| GAMAP 6 Consolidated financial statements and accounting for controlled entities |
| GAMAP 7 Accounting for investments in associates                                 |
| GAMAP 8 Financial reporting of interests in joint ventures                       |
| GAMAP 9 Revenue  |
| GAMAP 12 Inventories   |
| GAMAP 17 Property, Plant and Equipment   |
| GAMAP 19 Provisions, contingent liabilities and contingent assets                |

These 3 GRAP and 8 GAMAP standards are minimum standards to be complied with by municipalities and municipal entities. In the event that a municipality has transactions not covered in these accounting standards, the procedures mentioned in paragraphs .07 to .12 of GRAP 3 (which deals with accounting policies, changes in accounting estimates and errors) must be followed.

### **Specimen municipal annual financial statements**

We have issued three sets of specimen annual financial statements for large, medium and small municipalities. There are no major differences amongst all three specimens as they all meet the minimum compliance requirements. Where there are variations, these are attributable to the nature of transactions and balances they hold. These specimens are applicable to each municipality as follows:

- The specimen designed for large municipalities can be used for metropolitan and other big category B local municipalities;
- The specimen designed for medium sized municipalities can be used for other category B local and category C district municipalities; and
- The third specimen can be used for smaller municipalities having less complex structures.

These specimens are attached as guidance for your ease of reference and also available on the website of the Office of Accountant-General <http://oag.treasury.gov.za>

### **Consolidation specimen financial statements**

We have also prepared a consolidation specimen financial statements that is currently being finalized to be posted on the above websites. We will endeavour to finalize this by 28 July 2006. For those municipal entities that are preparing their annual financial statements in accordance with GAAP standards should continue to do so. Municipalities would be required to ensure appropriate adjustments are made when consolidations are prepared.

Due to the transition phase of GRAP introduction, there has been a need to have an agreed upon basis of preparation that would accurately reflect this transition. We draw attention to all municipal entities including those that are (Pty) Ltd to insert the attached paragraph as a basis of preparation of financial statements. The content of Annexure A has been prepared by the Office of the Accountant-General in consultation with the Auditor-General.

### **Timing and implementation by capacity**

All municipalities are required to prepare and submit their financial statements to the Auditor-General within 2 months of year end, i.e. by 31 August 2006. Further, for those municipalities that must prepare consolidated set of financial statements, this must be submitted by 30 September 2006 in terms of section 122 of the MFMA. It is a requirement that the municipality must provide two copies of the unaudited annual financial statements to the National Treasury, at the address indicated below, at the same time when it is submitted to the Auditor-General together with the confirmation of receipt from the Auditor-General, for our records. The final audited annual financial statements must also be submitted at the end

of the audit. It is a requirement that the accounting officer / municipal manager must sign the annual financial statements, prior to submission to the Auditor-General,

Once the financial statements are submitted to the Auditor-General, they should be tabled at the next meeting in Council for noting. Council approval is not required before submission to the Auditor-General, as was the old practices.

The table below shows the timing for preparation of consolidated annual financial statements and compliance with the accounting standards in terms of gazette 26510 and 26511 dated 25 June 2004 and 1 July 2004, respectively.

#### **Applicable dates for preparation of consolidated annual financial statements**

| <b>Capacity</b> | <b>Applicable financial years</b> |
|-----------------|-----------------------------------|
| High            | 2004/2005                         |
| Medium          | 2005/2006                         |
| Low             | 2006/2007                         |

#### **Applicable dates for compliance with GRAP**

| <b>Capacity</b> | <b>Applicable financial years</b> |
|-----------------|-----------------------------------|
| High            | 2005/2006                         |
| Medium          | 2006/2007                         |
| Low             | 2007/2008                         |

As in our previous correspondence, municipalities are encouraged to prepare their financial statements earlier than the legislated dates to become pro-active in understanding reform requirements and instituting process improvements to achieve the timelines. It is crucial that key aspect to the future positioning and readiness of municipalities to ensure optimal compliance with regard to GRAP implementation would require internal review and modernization of IT systems.

The Auditor-General is required by section 126(4) of the MFMA to complete the auditing of the annual financial statements of the municipality and the consolidated annual financial statements within three (3) months of receiving the financial statements. It is therefore, important that the municipality and its entities take all necessary steps to meet these key deadlines. It is also important to note that in terms of section 126(5) of the MFMA, no person may alter the audit report or the financial statements after the audit report has been issued.

#### **Withdrawal and resubmission of financial statements**

The past practices by municipalities of submitting, withdrawing and re-submitting of financial statements to the Auditor-General is noted with concern. It appears that this practice was as a result of preempting adverse audit opinions. However, we must also note that certain adjustments during the audit process may be required and should be accommodated in the audit process. Other weaknesses in financial management must also be addressed. For example, we would strongly recommend that the Chief Finance Officer take a leadership role in discussing issues raised in the management letter with the external auditors prior to

finalization of the audit with the objective of addressing as many issues as possible prior to the submission of the audit opinion. All this should be undertaken within the prescribed timeframes in the MFMA. We have raised this matter with the Auditor-General and wish to advise all municipalities that this past practice is strictly prohibited with effect from the date of this circular and is contrary to the spirit and good financial management espoused in the MFMA. Municipalities are therefore required to ensure that the necessary measures are implemented in the preparation of their financial statements that will be underpinned by quality and integrity prior to the final submission to the Auditor-General.

### **The municipal audit file**

In order to facilitate and manage an efficient and an organised audit process it would be necessary for the municipality to compile a Municipal Audit file. The file would be forwarded to the Auditor-General at the first management meeting with the accounting officer and chief finance officer. In addition, it would be necessary that the accounting officer/ municipal manager assign dedicated officials to specifically assist the chief finance officer in addressing all matters pertaining to the financial and performance audit.

The other critical element to assist in expediting the audit process, is the contents of the Municipal Audit file, to be compiled in consultation with the Auditor-General and the accounting officer / chief finance officer, at the pre-planning meeting for the audit.

On the guidance of the Auditor-General, the Municipal Audit file would consist of, amongst others, the following documentation:

- The 2005/06 Financial Statements and other supporting documentation. For municipalities with entities, the Consolidated Financial Statements should be included;
- A copy of the Trial Balance that reflects the balances as at 30 June 2006. All adjustments journals that are not reflected in the Trial Balance should be noted separately;
- The Assets Register that clearly indicates the opening balances, assets written-off, date of purchase and disposal. The register is required to contain adequate detail to trace the asset from the register to the physical asset, its value, detailed description of the assets and all assets in the register must reconcile to the Annual Financial Statements.
- The Valuation Roll that agrees with the rates reconciliation between the valuation roll and the rates that were levied. In addition, the Valuation Roll must contain third-party confirmation and the value of the Valuation Roll must be correctly stated in the Annual Financial Statements. The quality and integrity of the Valuation Roll must be able to undergo a reasonability test by the Auditor-General.
- The Statutory Funds with reference to the relevant supporting documentation that confirms all movements during the financial year under the audit process;
- The Loan Register with reference to outstanding loans that is underpinned by the redemption tables and the short-term portion per loan agreements. In addition, the supporting documentation to the Loan Register must contain the necessary authorised signatures, and the purpose for which the loan has been acquired;
- The Investment Register that makes reference to the investments that were made, withdrawn, interest accrued and any other charges to the investments. In addition, the register must reflect the correct value of the investment, the date of acquisition, the date of maturity and the purpose for which the investment is to be utilised upon maturity;

- The long-term Debtors with reference to the supporting documentation or agreement. The historical data on short-term debtors and what measures the municipality has implemented to recover the outstanding municipal debt;
- Bank reconciliations per month and the year-end;
- The schedule of provisions that were authorised during the year, their supporting documentation and all calculations supporting the movements;
- The Creditors' and Debtors' reconciliation with reference to the amounts and their supporting documentation;
- All suspense accounts are required to be cleared as at 30 June with the necessary supporting documentation. In the event there are un-cleared items in the suspense accounts, the accounting officer is required to provide detailed motivation on why such items still appear in the suspense account and also provide confirmation to the Auditor-General on corrective action to be taken.
- All control accounts are required to be correctly balanced and supported by necessary documentation;
- Monthly certified payrolls that agree with the relevant control accounts;
- Documentation that supports the asset and inventory counts at year-end;
- The bank and investment accounts in the name of the municipality;
- The municipality must provide both an electronic and hard copy of the General Ledger, Cash Book, Adjustment Journals as at 30 June to the Auditor-General. In addition, this would include any other information that would be required by the Auditor-General in the required formats.
- An evaluation of the 2005/06 Integrated Development Plan;
- The 2005/06 medium term budget;
- The performance agreements for the period under review;
- An evaluation of all approved policies and procedure manuals; and
- Progress reports from the Audit Committee that was implemented by the Accounting Officer for the past years including measures taken by the municipality to address previous audit findings.

The above serves as examples and is not conclusive. In order to keep the Audit File at manageable levels we encourage use of electronic medium, summary transaction reports and reconciliations could be included and references made to large supporting documentation that must be made readily accessible. The quality of the information in the Audit File and supporting documentation will greatly facilitate the completion of the audit and the related audit outcome.

### **Additional Disclosures**

We remind you of the various disclosures required in the MFMA especially contained in sections 123, 124 and 125, the regulations, accounting standards, and the Division of Revenue Act. Amongst the other disclosures we draw your attention to disclosures of grants received, expenditure incurred on such grants, payment of performance bonuses to senior managers and information relating to implementation of the new supply chain management system.

### **Non compliance with Chapter 12 of the MFMA**

Municipalities and municipal entities are reminded of the implications for non-submission or late submission of the financial statements as contained in section 133 of the MFMA. Municipalities are also reminded that no exemptions for late submission will be considered and Councils will be required to take corrective action including withholding of performance incentives against officials for such non-compliance.

The key and important aspect that relates to section 133 – “Consequences for Non Compliance of certain Provisions” of the MFMA would now empower the Auditor-General, in the event the accounting officer/ municipal manager fails to submit the Annual Financial Statements for the audit by the prescribed date, to inform the Speaker of the municipality, the National Treasury, MEC for Local Government and MEC for Finance of such a failure. The Auditor-General must also issue a special report on the failure to the relevant Provincial Legislature.

In addition and in terms of section 133 (2) the Auditor-General must submit to Parliament and the Provincial Legislature by no later than 31 October of each year, the names of any municipality and municipal entity which have failed to submit their Annual Financial Statements to the Auditor-General in terms of section 126, and repeat this procedure at quarterly intervals until received.

## Conclusion

To capacitate and skill municipal officials in implementing the new accounting standards, the Office of the Accountant-General, has conducted training workshops throughout the country over the past six months. It is trusted that the outcome of these workshops will enable municipalities to prepare financial statements and implement the standards. The Chief Finance Officer and other staff responsible for compiling the financial statements must prepare a step by step plan to ensure timely completion of all processes and procedures. A successful outcome in this regard will ensure that other processes beyond the audit, such as the compilation and tabling of annual and oversight reports are also completed with the required timeframes. These will finally assist the municipality in discharging its public accountability responsibilities to its residents in the utilization of public resources.

For further information and training requirements in the preparation and submission of Annual and Consolidated Financial Statements you may contact the Office of the Accountant-General through Ms Nonhlanhla Khumalo, telephone (012) 315 5334 and/or e-mail: [nonhlanhla.khumalo@treasury.gov.za](mailto:nonhlanhla.khumalo@treasury.gov.za)

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